No. 21795

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

ESTATE OF EUGENE L. FREELAND, Deceased, by SECURITY FIRST NATIONAL BANK, a national banking association, Executor, and VERA GOOD FREELAND, by L. N. TURRENTINE, Conservator,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITIONERS' REPLY BRIEF.

GEORGE T. ALTMAN,
424 South Beverly Drive,
Beverly Hills, Calif. 90212,

FRANK KOCKRITZ,
JAMES W. ARCHER,
GRAY, CARY, AMES & FRYE,
14th Floor, Bank of America Bldg.,
San Diego, Calif. 92101,

Attorneys for Petitioners.

Parker & Son, Inc., Law Printers, Los Angeles. Phone MA. 6-9171.

TOPICAL INDEX

TABLE OF AUTHORITIES CITED

No. 21795

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

ESTATE OF EUGENE L. FREELAND, Deceased, by SECURITY FIRST NATIONAL BANK, a national banking association, Executor, and VERA GOOD FREELAND, by L. N. TURRENTINE, Conservator,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITIONERS' REPLY BRIEF.

Comment on Respondent's "Statement."

Rule 18(3) of this Court very plainly states that no statement of the case is required of an appellee "unless that presented by appellant is controverted." But respondent here does not controvert a single sentence—even a single word—of petitioners' statement of the case. We could therefore properly ask this Court to ignore respondent's very lengthy statement in its entirety. But we need not do that. Indeed, respondent's statement reveals his reasons for disregarding this rule of the Court and presenting what appears intended as his own separate, very detailed, and complete statement of the case.

It is significant there that respondent gives weight to evidence which the Tax Court itself indicated deserved no weight. Thus, the Tax Court clearly indicated that it had no faith in Sam Berger's statements. [Tr. 212, lines 2-16.] One Theodore Jacobs, respondent's witness, had testified that Berger was a "common liar." [Tr. 210, line 12.] Yet respondent sets forth, Br. 6, Berger's representation to Kensington, Sam Berger Investment Company's vendor, that the purchase price would be paid off in about three years. And the principal evidence relied upon by respondent to show that the initial purpose of Sam Berger Investment Company was to develop the 4,500 acres consists, Br. 13, of public representations by Berger of which Freeland disapproved.

Significantly also, respondent's statement of the case sets forth in detail, Br. 9-10, the provisions of the original agreement, executed November 23, 1954, between Sam Berger Investment Company and Lake Murray Development Company. He does not mention the notices of non-responsibility filed on February 3, 1955, by Sam Berger Investment Company. And when he comes, Br. 15, to the changes made by the amended agreement of July 1, 1955, he omits to observe that it left no element of liability of, or gain to, Sam Berger Investment Company in connection with the activities of Lake Murray. What was left was an agreement which Sam Berger Investment Company could have made, in the light of its own purchase agreement, with any purchaser from it of a part of the acreage involved.[1]

---

[1]By a footnote, Br. 19, respondent suggests that petitioners "conceded" that respondent had not abused his discretion in reopening the taxable year 1956. Petitioners have, however, not so conceded; they have only elected not to raise that issue before this Court.

Reply to Respondent's "Summary of Argument."

In his "Summary of Argument," respondent again refers to Berger's representation that the purchase price of the property would be paid off in three years. There respondent again also relies on the original agreement between Sam Berger Investment Company and Lake Murray Development Company, especially, Br. 21, the guarantee contained therein by Sam Berger Investment Company of off-site costs. Respondent also refers to the offers of land by Sam Berger Investment Company to the School Board, although sales to that Board were required by the conditions of annexation of the property, conditions thus imposed long before Sam Berger Investment Company came into existence. Then respondent says that shortly after the demise of Lake Murray 80% of Sam Berger Investment Company was sold, an "unlikely event" if that company had decided to hold the property for investment. But he fails to note there that the owner of half of that 80%, Sam Berger, was himself then financially defunct, and that Tavares, the purchaser, and largest developer in the area, after he had bought Berger's half had asked the owners of the other half, including petitioners, to join with him in the development of the property and that they had refused. If they had been interested in development of the property they would have grasped at the chance. Indeed, Tavares had difficulty even in getting a price from petitioners for their interest. The clear conclusion is that their only purpose was to hold the property and certainly not to develop it.

Reply to Respondent's "Argument."

The Clearly Erroneous Rule.

Coming to respondent's "Argument," respondent begins, Br. 23, by pointing out the "clearly erroneous" rule applicable where the issue is strictly one of fact. But respondent's failure to controvert even a sentence of petitioner's "Statement," and his citation of numerous cases and statutory provisions, including attempted resort to sections of the Internal Revenue Code, 708 and 735, never mentioned by the Tax Court, contradict his assumption that the issue is strictly one of fact. Findings of fact are not binding upon this Court if they are induced by an erroneous view of the law. *Municipal Bond Corporation v. Commissioner* (CA 8), 382 F. 2d 184, 188 (1967). Nor are they binding upon this Court under the clearly erroneous rule if they are against the clear weight of the evidence. *Municipal Bond Corporation v. Commissioner, supra,* also at page 188.

In this connection respondent, as to the "normal criteria" in the problem here, says, Br. 23, that taxpayer notes they are lacking. As we pointed out, however, in our opening brief, at page 13, it was the Tax Court which observed those criteria were lacking. And contrary to respondent's implication, Br. 24, the absence of those criteria is an important factor here. *Hoover v. Commissioner,* 32 T.C. 618, 625.

In this connection also, respondent's fixation with the original agreement between Sam Berger Investment Company and Lake Murray, his repetition again and again of details thereof which do not appear in the amended agreement, and his blind disregard of the breach between the two entities which resulted in the

amendment, are especially significant. The purpose for which property was originally acquired or held is not determinative if that purpose has changed; the question is then whether the property was or was not held for sale to customers, in the ordinary course of trade or business, during the time ended by its sale. *Bynum v. Commissioner,* 46 T.C. 295, 299 (1966), citing *Mauldin v. Commissioner* (CA 10), 195 F. 2d 714, 717; *Todd Tibbals v. U.S.* (Ct. Cls.), 362 F. 2d 266, 273.

The Findings and Evidence.

Coming under his "Argument" to the findings and evidence, respondent concedes, Br. 26, footnote, that the members of Sam Berger Investment Company included men who were wealthy, men whose assets were as great as the entire amount which was owing on the land, which amount, moreover, was payable in installments over a period of *twenty years.* It is impossible to say therefore that they could not have held the land without selling any part of it, at least for a long time, and without even borrowing against it. Respondent's point there that there was no agreement for contributions by the individual members in such case is meaningless, since they could individually have advanced money by way of loans, and certainly would have done so as long as the equity was worth holding. Nor, since the land had greatly appreciated in value, is there any support for the notion necessarily implied by respondent that the property could not have been refinanced. Nor is there any support for the notion also necessarily implied by respondent that when a person invests in a property with payments spread over twenty years he is normally prepared at the very outset to pay off the total amount.

Respondent next repeats, Br. 27, his contention that petitioner's selling his interest alone justified a finding that the partnership was holding the property for sale to customers in the ordinary course of business. Of course, this begs the question. And the evidence is to the contrary. As observed above petitioners were first asked to join their purchaser, Tavares, in the development of the property but refused, and it was difficult for Tavares even to get a price. The very reluctance to sell is significant. *Municipal Bond Corporation v. Commissioner,* 46 TC. 219, 233, citing *Commissioner v. Pontchartrain* (CA 5), 349 F. 2d 416; affirmed and reversed on other issues, 382 F. 2d 184, *supra.* Indeed, under the facts the sale by petitioners was a forced sale; they did not want to develop the land, so that, because of Berger's sale to Tavares, whose purpose was the opposite, to develop the land, it would have been difficult for petitioners if they did not also sell. [Tavares dep., pp. 10-12.] Thus their very sale shows beyond question, we submit, that petitioners had no interest in development of the property but wanted only to hold it.

Next, Br. 28-29, respondent attempts, for the purpose of showing an interlocking of Sam Berger Investment Company and Lake Murray, to rely on "common interests" in those two entities. But he does not deny that almost immediately after the purchase of the property there was a rupture between those two entities, which never was healed. To treat them as "common" is simply to deny the record. As respondent concedes, Br. 11, par. (d), nothing could be done in the management of the partnership without Freeland's consent; and within two months after the partnership

agreement was executed Freeland made it clear by notices of non-responsibility that the partnership wanted no responsibility for the activities of Lake Murray, in which, except under a fee agreement for engineering services, he had no interest. Nor is there any showing whatever that, as respondent implies, Br. 29, the Barenfelds and Glaser, who, he says, were the persons who controlled Lake Murray, through the Country Club Park joint venture, were anything in Sam Berger Investment Company but the minority and strictly limited partners which they were; nor, as respondent implies, Br. 30, that Freeland as mere consulting engineer to Lake Murray was able to control that entity. Under very similar facts in a case just decided by the Tax Court, *Robert E. Ronhovde,* 26 T.C.M. 1251 (Dec. 1967), that court, at page 1258, recognized that the taxpayer's position as promoter and minority shareholder of the development corporation, to which the partnership there sold the land involved, did not taint the character of the partnership, as one holding the property for sale to customers in the ordinary course of trade or business, even though he was promoter, manager, and member of it also.[2] There is nothing whatever to support a notion of common control of the two entities here; and the actual activities between them completely negative it. Those are the "economic realities" for which respondent himself, Br. 30, contends. And, of course, after the total demise of Lake Murray, on May 4, 1956, more than half a year before Freeland sold his interest in Sam Berger In-

[2]CCH's original headnote on this case was erroneous. Petitioners are advised that it has since been corrected.

vestment Company, no relation between those two entities could exist.

Respondent, as his argument proceeds, continues to cling tenaciously to the original agreement between the two entities. He refers, Br. 31, to the "original plan" between them, in particular to the guarantee which it contained, by Sam Berger Investment Company, of the off-site and lot improvement costs. This he quotes the Tax Court as showing that this undertaking was unusual on the part of a pure seller of acreage. Sam Berger Investment Company had to get from Lake Murray the $200,000 which it needed to make the purchase in the first place, so that the agreement with Lake Murray was in effect a condition of the purchase. And those guarantees, which respondent there also quotes the Tax Court as calling the "interlocking participations," were eliminated in the amended agreement. This obviously is the reason that the latter agreement respondent studiously disregards.

In the same vein of reliance upon pre-amendment factors respondent, Br. 31-32, repeats Berger's initial bombast, about development of the 4,500 acres and payoff in three years, which as observed above in relation to respondent's "Statement" the Tax Court itself indicated deserved no weight. Also, by footnote, Br. 32, respondent refers again to the offers by Sam Berger Investment Company to the School District in respect to acreage for schools, et cetera. Respondent refers to those offers as "efforts" of Sam Berger Inevstment Company, but no "efforts" by it were required. The right of the School District to acquire such acreage was provided for in the conditions of annexation of the property, and this was long

before Sam Berger Investment Company was formed. All that the record shows is that that company was trying to conform to those conditions.

Respondent also here, Br. 32, quotes the Tax Court in reference to the price Lake Murray was required to pay under its option. We covered that point clearly and adequately in our opening brief, in the paragraph beginning at the bottom of page 14. But respondent makes no effort to reply. We must assume that he cannot.

Respondent finally, in a brief footnote, Br. 33, touches the issue of the amended agreement. But he does not say how the amendments left the agreement between the two entities. He refers to the disputes, as does the Tax Court, as arising out of the "working relationships" between the two entities. Just how a guarantee of costs could be a mere "working relationship," he does not explain. He does not deny that the amendments, as petitioners pointed out in their opening brief at page 7, eliminated the entire scheme of liability and gain of Sam Berger Investment Company in connection with the activities of Lake Murray. Nor does he even explain how the disputes arose if the two entities were "interlocked." It is no wonder that in every reliance of his on the agreement between the two entities he refers to the provisions of the original agreement, as if the amendments never took place.

Respondent next, Br. 34, insists that Lake Murray's demise cannot be used to predicate a change of purpose. But Lake Murray was not, in the beginning, a mere vendee. Without it Sam Berger Investment Company could not have obtained the off-site deposit of $200,000 required by its own vendor, Kensington. This

need was gone, and it did not have to be repeated. And it is *entirely* from the activities of Lake Murray, not as a buyer, but as an asserted "interlocking" entity, that the Tax Court drew its conclusion as to the character of the holding by Sam Berger Investment Company. Indeed, respondent, Br. 34-35, attempts to place a wholly unrelated entity, Tavares, in the same position merely because he was a developer, as if the purpose of the buyer, not the taxpayer, has any bearing on the issue. There is no basis whatever for saying that the characterization of Sam Berger Investment Company based on Lake Murray survived Lake Murray.

Next respondent, Br. 35-36, wonders why petitioner sold if he was holding the property for investment and not for development. But as we have pointed out above, Freeland was invited to join Tavares in development of the property and refused, and Tavares even had difficulty in getting a price from Freeland. Then why did Freeland sell, respondent appears to ask. Indeed, why does any investor sell, and what would the capital-gain provisions be for if an investor never sold? And how many investors do not sell when the price is high enough?

In reference to *Todd Tibbals v. United States, supra,* respondent in a footnote, Br. 35, says that it is inapplicable here because there the holding taxpayer was an individual, not, as here, a partnership. But there is absolutely no difference under the law between an individual and a partnership on the question whether, at the critical date, the property was or was not held for sale to customers in the ordinary course of trade or business. In regard to that case we refer to the detail of it shown in our opening brief, at pages 18-19. As we

pointed out there, the case here is clearer on the issue of change of purpose involved. Assuming here that the original purpose was to hold the property for sale to customers in the ordinary course of trade or business, the change from that purpose, even dating it from the demise of Lake Murray, or even from as late as Berger's sale to Tavares, occurred at all events before the sale by petitioners, and it is the date of that sale which is the critical one in determining the purpose of holding.[3]

Respondent then comes, Br. 37, and in a footnote there, to the Tax Court's finding that the plans of Sam Berger Investment Company at the time it acquired the property continued to govern its subsequent activities and that therefore we are not faced with a situation involving a change of purpose. Obviously, of course, since the Tax Court itself thus raised that question, it cannot be said, as respondent does, Br. 21, that we are raising it here for the first time. On that issue we will not repeat our analyses in respect to it given before.

Finally, Br. 37-38, respondent attempts to connect the increase in value of the property with activities of

---

[3]In the same footnote respondent attempts to involve Section 735 of IRC 1954 on the theory that, under Section 708(b)(1), Sam Berger Investment Company terminated when Sam Berger sold his interest, wherefrom he would invoke the character of holding on that date instead. But he points out nothing in the record to support the factual conditions required by Section 708(b)(1), either complete cessation of activity or a sale by that date of at least 50 per cent of the partnership. The partnership actively farmed the property, from 1954 through 1956 [T.C. 19; testimony of Margaret C. Lowthian, Tr. 184, lines 17-20]. And Berger's sale on August 10, 1956, was of only 40% of the partnership. Of course, this presents no issue anyway because, as shown, the purpose of holding for which respondent contends, predicated wholly on a relation to Lake Murray, necessarily terminated before Berger's sale.

Sam Berger Investment Company. He makes no attempt to say, which he could not, that that partnership, except for its farming of the land, had any activities at all. He again imputes to it the activities of Lake Murray. What he says is that the improvement of 150 acres by Lake Murray added value to the remaining 4350 acres as contiguous property, therefore the gain on the sale by petitioners of their interest in Sam Berger Investment Company was attributable to the activities of Lake Murray.

In the first place, the testimony involved related only to the effect which the improvement of the 150 acres had on the "contiguous property". [Travares dep., p. 19, line 26, to p. 20, line 2.] It could hardly be said that the entire 4350 acres were "contiguous" to the 150. Perhaps the 350 remaining under Lake Murray's option could be so described, but certainly not the other 4,000 acres, owned by Sam Berger Investment Company free of option. That would be like saying that the entire Pacific Ocean was "contiguous" to California.

Besides, if Lake Murray's gross failure on 150 adjoining acres added value to the partnership's land, the success of Bollenbacher & Kelton on 1300 adjoining acres must have added at least eight times as much value to the partnership's land. And how about the six or seven thousand homes built by Tavares alone in the San Diego area and the as many lots which he sold to other builders? And how about the rapid growth of San Diego generally, with the resulting continuing and substantial increase in its real estate values? All of this is pointed out in our opening brief, at pages 8-9.

But more important is the fact that even if Sam Berger Investment Company itself had improved that

150 acres of Lake Murray, the resulting incidental increase in value, if any, of the land which it still owned when petitioners sold their partnership interest would have been irrelevant. A person can develop a portion of a parcel of land, and if he does not hold the remainder of the parcel primarily for sale to customers in the ordinary course of his trade or business the gain by him on that remainder is capital gain. The sole question, under the statute, is the purpose for which the property involved in the sale at issue was, at the relevant time, primarily held. *Malat v. Riddell,* 382 U.S. 900.

Conclusion.

We submit in conclusion that the Tax Court's determination was based on erroneous imputation to Sam Berger Investment Company of the activities of Lake Murray, erroneous extension of that imputation from the 500 acres of Lake Murray, 150 being developed and 350 held under option by it, to the 4,000 acres of Sam Berger Investment Company in which Lake Murray had no interest, and, assuming that that imputation and that extension were proper at the beginning of the relation of those two entities, the erroneous disregard of the radical changes which subsequently occurred in that relation, and even of Lake Murray's demise. We submit therefore that that Court erred and should be reversed.

Respectfully submitted,

GEORGE T. ALTMAN,
Attorney for Petitioners.

Certificate.

I certify that, in the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit and that, in my opinion, the foregoing brief is in full compliance with those rules.

GEORGE T. ALTMAN